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Supreme Court, U. S.
FILED
JUN 14 1972
MICHAEL RODAK, JR., CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1971

## No.

ESTATE OF LAFAYETTE MONTGOMERY, DECEASED, TRUST COMPANY OF GEORGIA, ARTHUR L. MONTGOMERY AND GEORGE A. MONTGOMERY, EXECUTORS,

Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1971.

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No.

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ESTATE OF LAFAYETTE MONTGOMERY, DECEASED, TRUST COMPANY OF GEORGIA, ARTHUR L. MONTGOMERY AND GEORGE A. MONTGOMERY, EXECUTORS,

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versus

COMMISSIONER OF INTERNAL REVENUE,

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PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the opinion of the Court of Appeals for the Fifth Circuit dated April 18, 1972, pursuant to which the decision of the United States Tax Court was affirmed.

## OPINIONS IN THE COURTS BELOW

The opinion of the Tax Court is reported at 56 T.C. 489 (1971). The opinion of the Court of Appeals is not yet reported, but a copy of such opinion and of the judgment of the Court of Appeals is appended hereto at pp. 1a-6a of the Appendix.

## JURISDICTION

The opinion of the Court of Appeals and its judgment is dated April 18, 1972. Jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

## QUESTIONS PRESENTED FOR REVIEW

Whether the Court of Appeals erred in affirming the decision of the Tax Court that:

1. Prior to the purchase of the annuity-insurance combination plan in this case, National, decedent, and the trustees of the trusts entered into an understanding and agreement relating to the issuance of an annuity contract and two life insurance policies;

2. The decedent gave his consent to issuance of the two policies of insurance on his life by paying the first annual premium on each policy "through the trusts as conduits"; and

3. There was a single contract for the investment by decedent with National of the "aggregate amount of $2,465,876 (annuity premiums plus insurance premiums for one year) in return for a fixed monthly payment to decedent for his life with a provision, at his death, that $2,000,000 of the invested sum devolve to his beneficiaries; and that application of section 2039 called for inclusion of the

proceeds of the life insurance in decedent's gross estate."

## STATUTES AND REGULATIONS INVOLVED

The statute involved is the pertinent portion of Section 2039 of the Internal Revenue Code of 1954 (26 U.S.C. 2039). The regulation involved is the pertinent portion of Treasury Estate Tax Regulation ¶ 20.2039-1. Such portions of the statute and regulation are appended hereto at p. 8a of the Appendix.

## STATEMENT OF THE CASE

On May 4, 1964, the decedent, Lafayette Montgomery, created two irrevocable trusts for the benefit of his grandchildren, to each of which trusts he made a gift of $132,938. Decedent retained no interest in the trusts, either for himself or for his estate.

The next day the trustees of each trust as "Applicant" executed a written application to the National Life Insurance Company ("National") through its Atlanta, Georgia agency for a $1,000,000 policy of insurance on the decedent's life. In each application, the applicant trustees were named as "Owner" and "Beneficiary" of the insurance applied for. The decedent signed each application as "Proposed Insured" as required by Georgia law.

The following day, without proof of insurability of the decedent, National issued to each of the trusts the insurance policy thus applied for, the applicant trust-

ees in each instance being named as "Owner" and "Beneficiary" of the policy. Payment of the first annual premium on the policy issued to each trust was made by such trust from the cash given it by decedent.

On May 5, 1964, the decedent, as sole Annuitant, made written application to National for a single premium nonrefundable annuity contract, providing for monthly payments during his life of $22,632, with no survivorship benefits. The following day, National issued such annuity contract to decedent upon payment by him of the premium of $2,200,000.

The sales by National to decedent of the single premium nonrefundable life annuity; and to each of the trusts of a policy of insurance on decedent's life, were made pursuant to National's then business policy. Under such policy, National permitted, without proof of insurability, the purchase of annual premium life insurance if a nonrefundable life annuity contract were purchased on the life of the same person for a consideration of 110% of the face amount of such policies of insurance. National's policy was that it was a matter of complete indifference to it who applied for or purchased the annuity contract, or who might apply for or purchase such life insurance contract. National's "sole concern was that the annuity contract and the life contract be on the same life, . . ." National's Georgia salesman, Frederick, who made the sales of the policies of insurance to the trusts and the sale of the annuity contract to decedent, was in February or March 1964 advised by the decedent or his son, Arthur, that decedent was interested in acquiring an annuity

contract, but Frederick did not discuss the matter with decedent. Frederick's discussions were with decedent's attorney, to whom Frederick delivered the applications for an annuity and for life insurance, and such attorney obtained the necessary signatures on such applications and witnessed such signatures. Frederick did not testify as to any discussions with such attorney.

Following decedent's death in late October 1964, National paid the sum of $1,066,469 to each of the trusts, as required under the two policies of insurance on decedent's life.

In the Estate Tax Return of decedent, the aggregate amount ($265,876) of the two gifts of cash by decedent to the two trusts was included in decedent's gross estate as gifts in contemplation of death.

## REASONS FOR GRANTING THE WRIT

1. In affirming the decision of the Tax Court that, prior to the purchase by decedent of the annuity contract and by each of the two trusts of a policy of insurance on decedent, the decedent, National and the trustees of the trusts entered into an understanding and agreement with respect to such purchases relating to both the annuity and the two life insurance policies, the Court of Appeals rendered a decision which is without a scintilla of evidence to support it, and such decision is completely contrary to stipulated facts and oral evidence.

Thus:

Decedent retained no interest, rights, authority or powers of any kind under such trusts, either for himself or for his estate;

The cash given to each trust by decedent became the sole property of each trust, and the disbursement of such cash by each trust in payment of the first premium on the policy of insurance purchased by the trust was made solely by the trust and not by decedent;

The only agreement with National to which decedent was a party was the life annuity contract which was applied for and purchased by him from National. There was no other party to such contract and decedent was the sole annuitant thereunder;

The only parties to each of the two policies of insurance on decedent's life were the respective applicant trustees of each trust and National;

The respective trustees of each trust were the sole owner and beneficiary of the policy purchased and paid for by the trust;

Decedent as "Proposed Insured" signed the application by the trustees of each trust for insurance on decedent's life, as required by Georgia Code Section 56-2407;

> However, decedent was not a party to either such policy of insurance. Had he been a party thereto, his name as such party on the policies of insurance would have been required by Georgia Code Section 56-2413(2)(a).

Obviously, decedent knew that the trustees of each of the trusts were making an application for insurance on decedent's life, as evidenced by his signature on each application as "Proposed Insured" and by his gift of cash to each trust to enable it to pay the first annual premium on the insurance thus applied for by each trust. However, such knowledge by him clearly did not make him a party to the agreements (policies) of life insurance on his life, purchased by each trust from National.

This portion of the decision of the Tax Court, affirmed by the Court of Appeals, is thus subject to the same condemnation as that expressed by the Court of Claims in *Kramer* v. *U.S.*, 406 F.2d 1361, at 1368:

> "We hold that Section 2039 does not require inclusion ... in the gross estate, reiterating that this result turns on the fact as stipulated, not on the facts as suspected, speculated, or inferred. ..."

2. The affirmation by the Court of Appeals of the decision of the Tax Court that the two policies of insurance and the annuity contract constituted a single contract by decedent with National is clearly contrary to the decision of the Supreme Court in *Fidelity-Philadelphia Trust Co., et al.* v. *Smith, C.I.R.*, 356 U.S. 274; 78 S.Ct. 730.

In that case the decedent had purchased three series of annuity-life insurance policy combinations, the insurance policies being issued without requirement of a medical examination, but the insurance company requiring the decedent to purchase a single-premium, nonrefundable life annuity contract with each life insurance policy purchased. Premiums for both the life insurance policies and the annuity contracts were fixed at regular rates. The amount of each annuity was calculated so that in the event of the annuitant-insured's premature death, the amount of the annuity premium, less annuity payments made, would combine with the life insurance premium, plus interest, to equal the amount of insurance proceeds to be paid.

The decedent's children were named as primary beneficiaries of two of the insurance policies; and the Fidelity-Philadelphia Trust Company, as trustee of a trust established by decedent, was named beneficiary of the interest of any of decedent's children who predeceased her. In the year of such purchases by the decedent, she assigned all rights and benefits under these two life insurance policies to her children. The decedent's children were irrevocably named as beneficiaries of the third life insurance policy, but with the proceeds payable to decedent's estate if all her children predeceased her. Later by assignment the decedent included this insurance policy under the said trust agreement, and the policy was amended to name the trustee of such trust as contingent beneficiary of the policy.

Under the terms of the trust agreement the decedent had: reserved to herself all benefits, privileges, and

options under this policy; and reserved the right to change, amend or revoke the trust agreement. Later the decedent amended the trust agreement by: irrevocably assigning to the trustee of such trust all of her right, title and interest in all of the policies; empowering the trustee to exercise all options, benefits, rights and privileges under all of the policies; and making the trust agreement as thus amended irrevocable and unalterable.

The proceeds of the three insurance policies were not included in the decedent's gross estate in its estate tax return; and the Commissioner of Internal Revenue determined that such proceeds were includable and assessed a deficiency.

The question before the Supreme Court was whether the proceeds of such policies of insurance on the decedent's life, payable to named beneficiaries and irrevocably assigned by the insured, should be included in decedent's estate for purposes of the federal estate tax.

The parties conceded that this question was not determinable by the estate tax provisions dealing with life insurance proceeds.

The Government contended that such proceeds were includable in the gross estate under Section 811(c)(1)(B) of the Internal Revenue Code of 1939. This section required inclusion in the estate of a decedent, property to the extent of the decedent's interest therein, which the decedent had transferred without ade-

quate and full consideration, and under which transfer the decedent "... has retained for his life ... (i) the possession or enjoyment of, or the right to the income from, the property ..."

The Government contended that the decedent's retention for life of the right under the annuity contracts to annuity payments constituted income from property transferred to her children through the use of the life insurance policies.

The taxpayer, on the other hand, contended that the annuity payments were income from the annuity contracts, which were separate property from the insurance policies, and that since the decedent had assigned all rights under such policies prior to her death, she retained no interest in them at her death.

In rejecting the Government's contention and upholding that of the taxpayer, the Supreme Court said:

> "To establish its contention, the Government must aggregate the premiums of the annuity policies with those of the life insurance policies and establish that the annuity payments were derived as income from the entire investment. This proposition cannot be established. Admittedly, when the policies were purchased, each life insurance-annuity combination was the product of a single integrated transaction. However, the parties neither intended that, nor acted as if, any of the transactions would have a quality of indivisibility. *Regardless of the*

*considerations prompting the insurance companies to hedge their life insurance contracts with annuities, each time an annuity-life insurance combination was written, two items of property, an annuity policy and an insurance policy, were transferred to the purchaser.* The annuity policy could have been acquired separately, and the life insurance policy could have been, and was, conveyed separately. The annuities arose from personal obligations of the insurance companies which were in no way conditioned on the continued existence of the life insurance contracts. These periodic payments would have continued unimpaired and without diminution in size throughout the life of the insured even if the life insurance policies had been extinguished. Quite clearly the annuity payments arose solely from the annuity policies. The use and enjoyment of the annuity policies were entirely independent of the life insurance policies. Because of this independence, the Commissioner may not, by aggregating the two types of policies into one investment, conclude that by receiving the annuities, the decedent had retained income from the life insurance contracts." (Emphasis supplied) *Fidelity-Philadelphia Trust Company* v. *Smith, supra.*

For support of its position in the above case, the Government relied on *Helvering* v. *LeGierse*, 312 U.S. 531, 61 S.Ct. 643, wherein the Supreme Court held the proceeds of a policy of insurance purchased in com-

bination with a life annuity to be includable in the decedent's estate as a transfer to take effect in possession or enjoyment at or after death, under Section 302(c) of the Revenue Act of 1926.

In that case, however, the decedent had purchased both the annuity policy and the insurance policy combination, and had retained throughout his life all rights and benefits under the annuity contract and the insurance policy.

It was on the basis of the retention by the decedent until his death of all rights and benefits under the insurance policy on his life that such proceeds were held includable in the gross estate in *LeGierse*. This basic difference in the facts in *LeGierse* from those in *Fidelity-Philadelphia Trust Co.* is pointed out in the latter case, as follows:

> "The Government relies on Helvering v. LeGierse, supra, where this Court also had before it the issue of the taxability of proceeds from a life insurance policy in an annuity-life insurance combination. After holding that the taxability of these proceeds was not to be determined for estate tax purposes according to the statutory provisions dealing with life insurance, the Court held that the proceeds were includible in the estate under Section 302(c) of the Revenue Act of 1926 because they devolved on the beneficiaries in a transfer which took 'effect in possession or enjoyment at or after * * * death.' 312 U.S. at page 542, 61 S.Ct.

at page 650. However, in reaching this conclusion the decision did not consider the problem in the case at bar, for in Le Gierse the insured had retained the rights and benefits of the insurance policy until death. The facts in the instant case on this point are fundamentally different. Prior to death, the decedent had divested herself of all interests in the insurance policies, including the possibility that the funds would return to her or her estate if the beneficiaries predeceased her. The assignees became the 'owners' of the policies before her death; they had received the right to the immediate and unlimited use of the policies to the full extent of their worth."

Indeed, the taxpayer's position herein is stronger than that of the taxpayer in *Fidelity-Philadelphia Trust Co.* This results from the fact that: decedent, Montgomery, was at no time the owner of any interest, right, option or privilege of any kind in either of the two policies of insurance on his life; whereas the decedent involved in *Fidelity-Philadelphia Trust Co.* initially owned all such interests, rights, etc.

The Tax Court's refusal below to follow *Fidelity-Philadelphia Trust Co.* v. *Smith*, *supra*, and the Court of Appeal's affirmation of such action, was based on the Tax Court's erroneous Finding of Fact and Opinion that the annuity contract owned by decedent, Montgomery, and the policies of insurance on his life, owned by the two trusts, constituted a single, integrated "form of contract or agreement."

Moreover, the affirmance by the Court of Appeals of the decision of the Tax Court that the decedent entered into an *"understanding"* with National and the trustees of the two trusts relating to the issuance of both the annuity and the two policies of life insurance utterly ignores the fact that I.R.C. Section 2039, relates to "understandings" only insofar as they involve "plans" arising by reason of decedent's employment. Treas. Dept. Reg. 20.2039-1.

## CONCLUSION

For the reasons herein stated, it is respectfully prayed that a writ of certiorari be granted to review the judgment of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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**APPENDIX**

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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No. 71-3259

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ESTATE OF LAFAYETTE MONTGOMERY, Deceased, TRUST COMPANY OF GEORGIA, ARTHUR L. MONTGOMERY, and GEORGE A. MONTGOMERY, Executors,
Petitioners-Appellants,
versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

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Appeal from a Decision of the Tax Court of the United States (Georgia Case)

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(April 18, 1972)

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Before BROWN, Chief Judge, SIMPSON and MORGAN, Circuit Judges.

PER CURIAM: Consideration of the issues raised on this appeal requires that we apply the "any form

of contract or agreement" standard of Section 2039 of the Internal Revenue Code of 1954, Title 26, U.S.C., Section 2039, to an effort through use of a sophisticated device to utilize a claimed loophole in the federal estate tax statutes and thereby considerably reduce estate tax liability. We determine that the United States Tax Court was correct in finding that the device employed changed the form and not the substance of the transaction in question, in upholding the deficiency assessed by the Commissioner of Internal Revenue.[1] We affirm the Tax Court's decision reported at 56 T.C. 489 (1971).

The decedent, Lafayette Montgomery, on May 4, 1964 was approaching his seventy-fifth birthday and suffered from advanced pulmonary emphysema, chronic bronchitis, arteriosclerosis, labile hypertension, and hepatitis, his major health problem being severe pulmonary insufficiency due to emphysema and chronic bronchitis. On that date he executed instruments creating two irrevocable trusts for the benefit of his grandchildren. The co-Trustees of each trust were his two sons and the Trust Company of Georgia. The following

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[1]The Supreme Court's decision in *Fidelity-Philadelphia Trust Company v. Smith*, 1958, 356 U.S. 274, 78 S.Ct. 730, 2 L.E.2d 765, does not compel a different result in this case. *Fidelity-Philadelphia*, supra, was decided under Section 811(c) of the Internal Revenue Code of 1939 (transfers with retained life estate), the successor to which is Section 2036 of the Internal Revenue Code of 1954. The Commissioner of Internal Revenue in the case now at bar did not proceed pursuant to Section 2036 in including the life insurance proceeds in the gross estate of the decedent, Lafayette Montgomery, but pursuant to Section 2039, a provision which had no counterpart prior to the enactment of the 1954 Internal Revenue Code. The language and requirements of the two sections differ substantially.

day he made application to the National Life Insurance Company (National) for a life annuity on his life at a purchase price of $2,200,000, and the trustees of each of the two trusts made written application (executed by the decedent as the proposed insured) for life insurance in the amount of $1,000,000 on the decedent's life. The decedent presented no evidence of insurability and was of course not insurable at standard rates.

One day later, May 6, National issued its nonrefundable annuity contract to the decedent providing for monthly payments during his life of $22,682 with no survivor benefits. The same day National issued the two life insurance policies applied for to the trustees of the respective trusts in the face amount of $1,000,000 each. The annuity required payment of a single premium of $2,200,000, its face amount plus 10%, and the amount of the first annual premiums on each of the two life insurance policies was $132,938. The decedent procured a bank loan on May 8 in the amount of $2,500,000 and deposited the net proceeds of $2,465,876 in his personal bank account. From this account he paid the single premium on the annuity and issued to each of the two trusts his check in the amount of $132,938. The latter amounts were immediately used by the trusts to pay the premiums on the insurance policies.

National regularly offers a combination nonrefundable annuity and life insurance policy plan whereunder life insurance policies are issued, as here, without proof of insurability. As to annual premium life insurance National permits the purchase of a life insurance

policy provided the consideration paid for the annuity is equal to 110% of the face amount of the policy. Thus National incurs no insurance risk or risks of economic loss in such transactions since the annuity premium offsets the insurance policy proceeds and the annual premiums on the insurance policy offset the monthly payments under the annuity contract. Insurance policies would not have been issued without the purchase of the annuity contract since no evidence of the decedent's insurability was submitted. Neither would the policies have been issued by National without the decedent's consent, which was required by Georgia law. The decedent's consent was evidenced by his witnessing the applications, though National had no concern with the identity of the named beneficiaries under the insurance policies so long as they were on the same life as the annuity contract.

The decedent died October 31, 1964, less than six months after the transactions above described. National paid the sum of $1,066,469 due under each of the policies to each of the trusts. The excess amount of $66,469 represented a refund of one-half of the annual premium paid on each policy.

A gift tax return for the year 1964 was filed by the taxpayer on behalf of the decedent on April 15, 1965, reporting as gifts the $132,938 given to each trust to pay the first annual premium on each policy. The estate tax return, filed January 31, 1966, also reported these amounts as transfers *inter vivos* subject to the estate tax and claimed a credit for the federal gift taxes paid with respect to the transfers. The sum of

$2,465,876 representing the net proceeds of the bank loan obtained by the decedent to pay the premiums on the annuity and life insurance contracts was deducted as a debt of the estate. The amounts received by the trustees from the policies issued by National on the decedent's life were not included in the decedent's reported gross estate, but were specifically excluded on the asserted ground that the decedent had no interest in them.

The Commissioner of Internal Revenue did not question the claimed deduction pertaining to the estate's indebtedness to the bank. But the Commissioner determined that the proceeds ($2,132,938) of the two life insurance policies were includible in the decedent's gross estate under the provisions of Section 2035 (transactions in contemplation of death) as well as Section 2039 of the Internal Revenue Code of 1954. The Tax Court held the proceeds includible under Section 2039 and found it unnecessary to consider the question of applicability of Section 2035.

On this appeal the taxpayer argues that the Tax Court was in error when it found as factual matters that:

1. Prior to the purchases of the annuity-insurance combination plan in this case, National, decedent, and the trustees of the trusts entered into an understanding and agreement with respect to the above transactions relating to the issuance of both the annuity and the life insurance policies.

2. That the decedent gave his consent to the issuance of the two policies of insurance on his life by paying the first annual premium on each through the trusts as conduits.
3. That there was a single investment contract between the decedent and National Life Insurance Company.

Regarding the Tax Court's legal conclusion, the taxpayer disputes the includibility of the proceeds of the two life insurance policies under Section 2039.

Our scope of review of the decisions of the Tax Court under Title 26, U.S.C., Section 7482(a), is "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury". Applying the "clearly erroneous" test of Rule 52(a), F.R.Civ.P., to the facts found by the Tax Court, we perceive no reason to disturb those findings of fact. Given these factual findings, no error is demonstrated in the Tax Court's holding that the proceeds of the insurance policies were includible in the decedent's gross estate under Section 2039 of the Internal Revenue Code. In this posture of the case we agree with the Tax Court that it is unnecessary to consider whether or not the proceeds are also includible under Section 2035 of the Internal Revenue Code.

The decision of the Tax Court is

AFFIRMED.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1971

No. 71-3259

T. C. Docket No. 754-69

ESTATE OF LAFAYETTE MONTGOMERY, Deceased, TRUST COMPANY OF GEORGIA, ARTHUR L. MONTGOMERY, and GEORGE A. MONTGOMERY, Executors,
Petitioners-Appellants,
versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeal from a Decision of the Tax Court of the United States (Georgia Case)

Before BROWN, Chief Judge, SIMPSON and MORGAN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record of the Tax Court of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed;

It is further ordered that petitioners-appellants pay to respondent-appellee the costs on appeal to be taxed by the Clerk of this Court.

April 18, 1972

Issued as Mandate:

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"The term 'contract or agreement' includes any arrangement, *understanding* or plan, or any combination of arrangements, *understandings* or plans *arising by reason of the decedent's employment.*" (Emphasis supplied) Estate Tax Reg. Sec. 20.2039-1(b).

"The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 * * * if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death."

I.R.C. Sec. 2039; 26 U.S.C. 2039(a).